

Italy elections – populists gain ground

SUMMARY

- **Italy's centre-right coalition appears to have the best chance of forming a government** under anti-immigrant League leader Matteo Salvini after voters elected a hung parliament.
- **The Eurosceptic Five Star party emerged as the single largest party in parliament**, giving it a significant bargaining chip should Salvini fail to negotiate a stable government with his coalition partner Forza Italia, led by former Prime Minister Silvio Berlusconi.
- **Italy's stocks fell and bond yields rose as the rise in populist parties** revives concerns about economic and political stability in the Euro area's third-largest economy. However, Euro area assets were less impacted, given the broader region's robust outlook.

BACKGROUND

- **Lacking a majority.** The centre-right coalition of anti-immigrant League, Berlusconi's Forza Italia and far-right Brothers of Italy won 37% of the votes for the lower house, according to preliminary results. The Five Star party won 32.7%, while the ruling Centre-left coalition won 22.9%. In the Senate, the centre-right won 37.5% to Five Star's 32.2% and Centre-left's 23%. A stable government needs a majority in both the lower house and the Senate.
- **High unemployment, immigration dominate election.** Italy's economic output remains 5.7% lower than pre-global financial crisis levels, with its economic recovery lagging the rest of the Euro area. Unemployment at 11% remains well above the Euro area's 8.7% rate. However, economic growth has been recovering over the past year after the government bailout of some troubled lenders.

WHAT DOES THIS MEAN FOR INVESTORS?

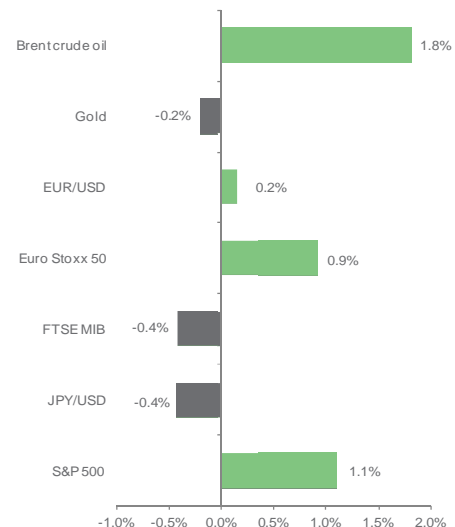
- **Centre-right coalition likely the best outcome to secure Italy's recovery.** Although there are significant differences among the coalition partners, including on their views on tax cuts, pension reform and the EUR as a common currency (Salvini, in his victory speech, said the EUR is 'bound to come to an end'), the coalition is more open to reform that Italy needs to revive productivity than the Five Star party. However, both are likely to raise Italy's public debt, already among the highest in the developed world.
- **Remain constructive on broader Euro area assets.** The rest of the region continues to recover strongly, helped by record low borrowing costs and strong global growth. Unlike in Italy, elections in France, Germany and the Netherlands in 2017 had kept anti-establishment and populist parties in check. This stable backdrop keeps us bullish on the EUR over the medium term. We also retain Euro area stocks as a core holding, given their attractive valuations.

WHAT NEXT?

- **House and Senate speaker elections.** The first test of the strength of the various coalitions is likely to be the election of the speaker of the lower House and the Senate when they open on 23 March. Italy's President could decide to invite a leader to form a government based on the outcome of the speaker's elections.

Safe-haven assets such as JPY and gold fell, while Euro area stocks and the EUR rose following the release of the Italian results

Change in asset prices, 05-Mar-2018 vs. 02-Mar-2018



Source: Bloomberg, Standard Chartered

Italian bond yield premiums have been declining over the past year on the back of an economic recovery; they rose marginally after the elections

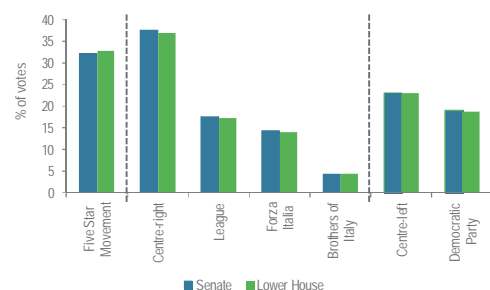
Italy 10yr bond yield premium over German bunds, %



Source: Bloomberg, Standard Chartered

Populist parties have gained significantly in the elections this year

Vote share in the Senate and Lower House, based on preliminary results



Source: Bloomberg, Standard Chartered

Disclosure Appendix

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